BEFORE THE

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

WASHINGTON, D. C.

ORDER NO. 564

SERVED January 26, 1966

In the matter of:

Application of D. C. Transit System, Inc., for authority to increase fares	Application No. 344 Docket No. 101

APPEARANCES:

Harvey M. Spear, Edmund L. Jones, Manuel J. Davis, Leon G. R. Spoliansky, William T. Reynolds, Samuel M. Langerman, Attorneys for D. C. Transit System, Inc., Applicant.

Leonard N. Bebchick and *Stanley O. Sher,* Attorneys for: Leonard N. Bebchick, Linda Sher, Daniel Gottlieb, Samuel Krafsur, Protestants; D. C. Federation of Civic Associations, Protestant; The Democratic Central Committee of D. C., Intervenor.

Thomas Lyon, pro se, Protestant.

Diana K. Powell, pro se and Republican Precinct 46, Protestants.

L. Paul Smith, for the Deanwood Civic Association, Protestant.

Fred Meissner, pro se, Protestant.

Lester McKennie, Sharlene Kranz, and *William Higgs,* pro se, Protestants.

Herman Sternstein, Attorney for Local Division 689, Amalgamated Transit Union, AFL-CIO.

Russell W. Cunningham, General Counsel, Washington Metropolitan Area Transit Commission.

Before Charles M. Duke, Chairman, Edward D. Storm, Vice Chairman, H. Lester Hooker, Commissioner.

On September 17, 1965, D. C. Transit System, Inc., filed an application seeking authority to increase fares for the transportation of passengers within the District of Columbia, within the State of Maryland, and between the District of Columbia and points in Maryland, all of which territory lies within the territorial jurisdiction of the Washington Metropolitan Area Transit Commission ("Commission").

By its application, which was accompanied by appropriate tariffs, D. C. Transit System, Inc. ("Transit"), seeks authority from this Commission to increase its charges for tokens from four tokens for 85¢ to four tokens for $1.00; increase its District of Columbia cash fare from 25¢ to 30¢; increase its D. C. Downtowner Minibus fare from 5¢ to 10¢; increase its Maryland cash fare for the first zone of coverage, or any part thereof, from 15¢ to 20¢; increase its fare for express route service between Maryland and the District of Columbia by 5¢; increase the fare for the Capitol Hill express service from 50¢ to 60¢; increase by 5¢ the cost of joint fare tickets; increase its 10-ride commutation ticket by 50¢ (5¢ increase per ride). At the same time, applicant filed an additional tariff requesting to increase the cash fare for its special operations between points in the Washington Metropolitan Area and D. C. Stadium from 50¢ to 60¢. No changes are proposed in the school fares or the fare for the Silver Rocket Express.

The proposed fares were suspended until February 5, 1966, pursuant to Section 6(a), Article XII, Title II of the Washington Metropolitan Area Transit Regulation Compact ("Compact").

Informal protests to the proposed increase in fares were filed by a number of individual transit riders, all of whom were given an opportunity to testify at a special evening hearing called for this purpose. Thirty-four of such individuals appeared and made statements for themselves or organizations which they represented. Formal protests were filed by certain individuals, groups and organizations, as shown under the "APPEARANCES" of this Order. The Central Democratic Committee was permitted to intervene after the proceeding had commenced, and *only* after Transit voluntarily withdrew its objections.

Pursuant to notice, duly given in accordance with the Commission's Rules and Regulations, public hearings on the application commenced on November 8, 1965, and continued intermittently for fourteen (14) days, through and including January 5, 1966.

Transit presented the testimony of its First Vice President, Morris Fox; its Vice President and Comptroller, Parker C. Peterman; its Vice President for Maintenance and Operations, Alfred E. Savage; V. A. McElfresh of H. Zinder and Associates, Inc; Seymour S. Mintz of Hogan and Hartson, Attorneys at Law; Robert R. Nathan of Robert I. Nathan Associates, Inc.; Thomas F. Airis, Director of the D. C. Department of Highways and Traffic; and Walter J. Bierwagen, International Vice President of the Amalgamated Transit Union. The Commission's staff presented the testimony of its Chief Accountant, Melvin E. Lewis, and its Chief Engineer, Charles W. Overhouse. The only other party to present formal testimony at the hearing was intervenor, Democratic Central Committee, which presented the testimony of Edgar H. Bernstein.

The combined testimony of these expert witnesses have produced a record containing 2,253 pages of oral testimony and some 127 exhibits.

The principal reason advanced by Transit for fare relief was increased operating expenses brought on by a new, one-year labor contract, which, it asserted, would add over $1.5 million to its labor costs in the calendar year 1966. In its application Transit used the actual operating results for the twelve-month period ended June

30, 1965, as the test period for purposes of projecting future results. The calendar year 1966 was used by Transit for the future test period. The Commission's staff also used the identical test periods, both past and future, as used by Transit.

AUDITING

The numerous adjustments made by the staff in the recorded operating expenses of Transit, the great majority of which went uncontested, point up a problem which has concerned the Commission for some time.

The magnitude of the adjustments required, both as to number and the amount thereof, indicate very forcibly that an abnormal situation exists. The abnormal situation stems from Transit's affiliation with numerous companies engaged in many diverse, non-transit actitivites. These non-transit activities permeate the duty assignments, to some extent, of almost every administrative and executive employee of Transit. We have no fear but what the staff, in making its adjustments, generally resolved all doubt "in favor of the ratepayer," but such practice tends to penalize Transit rather than solve the problem.

We urge Transit to consider, voluntarily, separating completely its transit and non-transit activities so that Transit's personnel will not be involved in non-transit functions.

LABOR CONTRACT NEGOTIATIONS

One of the intervenors alleged that the new labor contract, effective November 1, 1965, was not entered into as result of arms-length bargaining, but did not offer any evidence in support of such allegation. While the Commission will not interfere with arms-length bargaining, it will in all cases satisfy itself that such bargaining took place. The Commission is satisfied, after reviewing the evidence, that this contract was negotiated on an arms-length basis.

PROJECTIONS

Pertinent to any discussion of future projections of Transit are two items which have been issues in every prior rate case involving Transit, namely, Acquisition Adjustment Account and Reserve for Track Removal and Repaving.

Acquisition Adjustment Account

The Acquisition Adjustment Account reflects the net effect of two basic purchase transactions. One involved the acquisition of the Old Capital Transit Company on August 15, 1956, reflected in an original difference between purchase price and aboriginal cost per-the-books in the amount of $10,339,041.19. The second acquisition adjustment reflected the purchase of the Inter County Bus Company in April of 1960. In this instance the purchase price exceeded book value by $82,397.00. In the latter case, it should be noted, the Public Utilities Commission of the District of Columbia, on August 17, 1960, directed that this $82,397.00 acquisition adjustment be charged off on a monthly basis over the remaining life of D. C. Transit's franchise, namely, sixteen years and four months to August 15, 1976. At issue here in this case is the effect of WMATC Order No. 385, dated September 11, 1964, the effect of which was to cease the ten-year amortization rate on the $10,000,000 credit acquisition adjustment as of January 1, 1964, and to begin a different rate of amortization, gauged to spread the remaining balance in the acquisition adjustment account over the remaining 151.5 months left in the franchise period of D. C. Transit System, Inc. Therefore, for the years 1964 and 1965, Transit's books showed a credit to income in the amount of $199,561.08 per year for this item, instead of the annual amount of $1,033,904.12 previously in effect. Actually, since tax adjustments were made to the acquisition adjustment account based on settlements pertaining to the original purchase transaction between Capital Transit and D. C. Transit System, Inc., the annual amortization rate under the original ten-year plan would have been hereafter $959,793.60.

As was pointed out in Order No. 385, if Transit were permitted to continue amortizing the then remaining balance of the acquisition adjustment account at the rate of approximately $1,000,000 per year, the entire balance would be completely written off by mid-1966. The Commission further noted in its Order that if this credit balance were permitted to be exhausted in this manner, the effect would be that Transit's annual income would suddenly drop at the drastic amount of approximately $1,000,000 a year. Consequently, at a time when the action of the Commission would have no adverse effect on the fare structure of Transit, from the ratepayers' point of view, the Commission acted to avoid this eventuality. One of the intervenors made the argument that the Commission acted injudiciously in revising the amortization rate of the acquisition adjustment account. The fallacy of this argument is highlighted by intervenor's own contention that the present balance of almost $2,000,000 (which would have not been there except for the Commission's action), should now be amortized over the next two years. If the Commission were to follow this suggestion, it would be creating the same situation which it corrected in 1964.

In light of the above we fail to see any merit in intervenor's argument that the rate of amortization of the acquisition adjustment account should be adjusted.

Track Removal and Repaving

Since August 16, 1956, Transit had been accruing some one million dollars a year into a Reserve for Track Removal and Repaving. By the end of 1962, the total accrued to this Reserve was over six and one-half million dollars and the amount charged against the Reserve as of that date was something under two million dollars. Accordingly, by Order No. 245, served April 12, 1963, the Commission forbade any further accruals to this Reserve on and after January 1, 1963, pending further orders of the Commission. The balance in the Reserve, unexpended as of December 31, 1962, was $4,814,250. Expenditures since 1963 for Track Removal and Repaving have now brought this balance down to a substantially lower level than it was on January 1, 1963.

Staff testimony developed a maximum estimated excess of track removal requirements for the period ending December 31, 1966, over available balance in the Reserve for Track Removal at June 30, 1965, in the amount of $153,074.43. The staff had adjusted the Reserve Account for errors and other corrections totaling $287,114.00 of which $65,042.00 was unchallenged by Transit. The remaining $222,000.00 involved provision for D.C. income taxes. Staff testimony also provided for budgeted and unbudgeted contracts estimated to be billed to D.C. Transit by the Director of the D.C. Department of Highways and Traffic, covering the period from July 1, 1965, to December 31, 1966, including a $34,000 adjustment not included in the Highway Department's forecast but actually billed to Transit after July 1, 1965.

The $222,000.00 adjustment on account of D. C. income taxes was made to conform with the "net of taxes" treatment instituted by the Public Utilities Commission in its Order No. 3592. If the charges to the account were generated on a "net of taxes" basis, and continued thus over a seven-year period as long as debit adjustments were required, consistency demands that, now that the time has arrived for the credit entries, the procedure set up by the PUC be continued to its logical conclusion. In order to expedite the carrying out of this directive, Transit is directed to remove the amount of $222,072.22

from the Reserve for Track Removal by crediting such account; the contra-debit will be to an account entitled "Deferred Tax Charges—Track Removal Costs."

The Commission likewise will, in its forthcoming certification, for the fiscal period ended August 31, 1964, covering the various certifications pertaining to D.C. Transit System, Inc., charge as an operating expense for that period five percent of the net cost of track removal and repaving as incurred during the year 1963 and the first eight months of 1964. The staff, and Transit as well, should continue the entire "net of taxes" treatment of track removal expenditures until the entire amount of $222,072.22 is offset. The Commission takes note of PUC Order 3592-59, page 5 thereof, which reads as follows:

> . . . to the extent that the provision for track removal and repaving is currently disallowed for tax purposes, the resulting increase in income taxes should be charged to the account Reserve for Track Removal and Repaving, so that provision is made on a "net of taxes" basis. Under this procedure the customers will not be currently charged with the total estimated cost of track removal and repaving without the off-setting benefit of the related reduction in income taxes.

It is clear to the Commission that Transit has been on notice since PUC Order No. 3592-59 was issued in 1959, and has, in fact, kept its books on a "net of taxes" basis since 1956. Consistency demands that this "net of taxes" treatment be continued until the charges that were built up between 1956 and 1962 are completely offset by credits to the deferred tax account and debits in the proper amount, as indicated above, to the operating taxes for the years in which actual costs were incurred.

The Commission finds that the charges and credits indicated in staff testimony are proper and that, to the extent that projected costs and expenditures are accurate, there will be an excess of track removal requirement over available balance in the Reserve for Track Removal in the amount of $153,074.43. However, the Commission, aware of the great practical difficulties in the past of forecasting track removal costs and noting the testimony with regard to the considerable slippage possibilities in timing the projects, is of the opinion that the balance in this Reserve is adequate to cover projected costs for 1966.

The basic fact to be faced here for the long run is that the liability of Transit to remove and cover track is contained in Section 7 of the Act granting the franchise to Transit the cost of such removal and covering work has been and remains the final liability of the ratepayer. Since August 15, 1956, all accruals for this work have been charged to and paid by the ratepayer. The difficulty now is that what was once considered a ten-million dollar project is now not even subject to exact estimate as to ultimate cost. Much track has been covered rather than removed. Such cover may be utilized efficiently for ten, twenty or more years in the future, with no need ever to disturb the underlying track. However, technically, at some future period, even twenty years hence, if the need occurs to dig up the street and remove that track it is Transit's liability and responsibility to pay for it; this is another way, of course, of saying it is the ratepayers' liability.

The sum and substance of the foregoing discussion is that by the end of 1966 the balance in the Track Removal Reserve will be nil under the current track removal program. Anticipating such an event at some future date, the Commission stated in Order No. 245:

> The Commission will keep abreast of the Track Removal and Repaving program of the District of Columbia and if, at any time, because of a change in the program, there appears to be a need for resumption of accruals to this reserve, the Commission will act accordingly.

As the financial burden of the track removal pro-

> gram falls upon the ratepayer, consideration should be given to having Congress relieve the applicant of this indefinite future obligation.

In the absence of a drastic change in the track removal and repaving program of the District of Columbia in 1966, the Commission will have no other alternative but to allow Transit, effective January 1, 1967, to resume accruals to this Reserve in an amount of between $800,000 and $1,000,000 per year for the next three or four years.[1] This additional cost to the ratepayers, in terms of token fares, before calculating the tax effect, is equivalent to a fare increase of approximately a cent and a quarter (1-1/4¢).

This liability was formalized as far back as 1942. There is no question but what at that time a long-range program consisting of sporadic projects, was contemplated. Subsequent legislation requiring conversion to an all-bus system has, however, had the effect of creating what could be called, in comparison, a crash program. The phasing out of rail operations was accelerated, the only brake upon it being the congressional mandate to tie the conversion program to the highway construction program.

A combination of events has caused both programs to be accelerated. The impact, while slow in developing, has been tremendous, creating a strenuous burden on the transit rider and on Transit. As the transit rider has borne the financial burden up to this point, we feel our recommendation to the Congres is both timely and equitable.

In order that the ratepayer may be saved from the inevitable consequences, we again recommend that Congress, immediately, relieve Transit, and in consequence, Transit's riders, of this obligation.

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[1] Transcript, page 1484.

PROJECTION OF REVENUES AND EXPENSES FOR 1966 UNDER PRESENT FARES

The Commission has considered carefully the testimony of both Transit and the staff, including the rebuttal testimony of Transit, in regard to projection of revenues and expenses for 1966 under present fares. Transit agreed with the majority of the staff adjustments. The major adjustments brought into issue are as follows:

1. *Revenue Projections.* Transit estimated gross operating revenues in 1966 to be $32,698,744 at present fares. In arriving at this estimate it used the operating revenues for the twelve months ended June 30, 1965, as a base and made certain adjustments as indicated below:

Operating Revenues	Actual 12 Months Ended June 30, 1965	Adjustment	Future Annual Period at Present Fares
Passengers	$29,837,656	$ 717,422	$30,555,078
Charter Bus	1,648,511	200,000	1,848,511
Government Contracts	126,124	(9,266)	116,858
Station and Vehicle	108,168		108,168
Other	(30,878)	101,037	70,159
TOTAL Operating Revenues	$31,689,581	$1,009,193	$32,698,774

The staff, in estimating regular route passenger revenues for 1966 at present fares, used passengers transported and operating revenues for the twelve-month period ending June 30, 1965, as a base; projected passengers for the calendar year 1965 based on historical trends, and then estimated the number of passengers to be transported and the amount of revenue to be received by continuing or adjusting the trends through 1966. The staff estimate of operating revenues for 1966 under present fares was $33,363,694.00.

The major differences between the estimates of Transit and staff in revenues for 1966 were in regular route and charter revenues. The staff projected $253,797 more in regular route revenue and $410,000 more in charter revenue than estimated by Transit.

Transit did not take issue with the additional charter revenue projected by the staff.

In an attempt to rebut the staff's testimony, Transit testified that it transported 137,352,588 regular route passengers and received $30,133,559 in regular route revenue plus an estimated $50,000 for token ticket write-off-adjustments for a total of $30,183,559 in 1965. The staff estimated revenue passengers for 1965 but did not project passenger revenues. Had it estimated revenues for 1965 based on its passenger projections, the revenue figure would have been $30,233,432. This figure represents $49,873 more revenue than Transit reported for 1965.

Transit also offered into evidence rebuttal testimony comparing passengers and revenue between 1964 and 1965. The staff had insufficient time to verify the figures submitted due to the lateness of filing by Transit. However, our investigation of Transit's rebuttal testimony after the termination of the hearings, reveals that Transit made several errors, resulting in an understatement of its revenues for 1964 by $352,178, the corrected figure being $29,656,635, and not $29,304,457 as testified to by Transit.

The Commission favors the method used by the staff in the projection of future revenues. However, considering the July through December, 1965, experience of Transit (not available to the staff or Transit at the commencement of the hearings), which was used by Transit in rebuttal testimony, it appears that the staff's estimate of future revenue may be high. Regular route revenue for 1965, as testified to by Transit, was $30,183,559. The regular route revenue in 1964 was $29,656,635. This indicates a 1.8% revenue increase, 1965 over 1964.

Considering all facts before it, the Commission finds that under present fares Transit will receive $30,726,863 in regular route revenue in 1966 which represents a 1.8% increase over 1965.

Based on all evidence and facts, the Commission finds that under present fares the Total Operating Revenues for 1966 will be:

Regular Route	$30,726,863
Charter	2,258,511
Government Contracts	116,858
Station, Vehicle & Other	179,450
Total Operating Revenue	$33,281,682

2. *Injuries and Damages.* Transit contends, by its testimony and exhibits, that the amount to be credited to the Reserve for Injuries and Damages should continue to be 4% of gross revenue. This would amount to $1,331,267 in 1966 under present fares.

The main purpose of an Injuries and Damages Reserve is to reserve a sufficient amount of money to adequately satisfy the settlement of claims for injuries and damages that are pending.

The staff presented the following testimony concerning Injuries and Damages Reserve:

YEAR	CREDITS	CHARGES	CUMULATIVE AVG. CHARGES	ADJUSTED OUT-STANDING RE-SERVES FOR OPEN CLAIMS	BALANCE END OF YEAR
1960	$1,241,254	$1,086,173	$ ---	$1,704,868	$2,006,015
1961	1,261,445	1,329,356	1,207,764	1,682,496	1,938,104
1962	1,262,190	1,269,726	1,228,418	1,750,300	1,930,568
1963	1,234,874	1,372,087	1,264,335	1,604,695	1,793,355
1964	1,266,530	1,246,001	1,260,669	1,570,342	1,813,884

. The balance at year end has always exceeded the adjusted outstanding reserves for open claims. The staff estimated that $1,300,000 is a reasonable amount to be credited to the Reserve in 1966. This amount of credit should leave a sufficient amount in the Reserve balance to meet the adjusted outstanding reserves for open claims.

The Commission finds that an annual amount of $1,300,000 is reasonable to be credited to the Reserve. The Commission is of the opinion that one-twelfth (1/12) of such amount should be credited to the Reserve each month commencing January 1, 1966. This amount may be changed by order of the Commission for good cause.

3. *Certain Executive Salaries and Bonuses.* The Commission has consistently disallowed bonus payments to executives as an operating expense for rate-making purposes; the retention by Transit of the option to pay or not to pay these bonuses removes these charges as proper charges for rate-making purposes. The Commission accepts the salary adjustments made by the staff except it will recognize and allow for rate-making purposes the full salaries paid Mr. Flanagan and Mr. Chalk for 1965, being satisfied that they each fall within the discretionary limits of management.

It should be pointed out that if Transit follows the Commission's suggestion as to the separation of transit and non-transit activities, then the need for the staff's recommendations with regard to salaries in the future will have been removed.

4. *Cost-of-living Increases.* The Commission will give full force and effect to the actual cost-of-living increases which have taken place up to the present time, which include the 1/2¢ increase in October, 1965, and the 2-1/2¢ increase in January of 1966.

5. *Limousine Driver Wages.* On this record, the Commission finds no reason why any labor costs, and costs associated with labor, involved in driving limou-

sines, should be borne, in any percentage, by the rate-payer. Management has been uninformed as to the extent to which make-up time is utilized in limousine and charter work. It behooves Transit to address itself immediately to the problem of optimal utilization of every hour of labor available to it.

6. *Adjustment for Maintenance Costs*. Included in operating expenses are accounts 1304, 1305, 1306, 1315 and 1316, the so-called "maintenance expense accounts." Account 1304 consists of labor and material costs for air-conditioned units and maintenance of bus bodies, account 1305 consists of labor and material costs for chassis maintenance, account 1306 consists of rental cost of tires and tubes which is computed on a mileage basis, account 1315 consists of motor fuel costs, and account 1316 consists of lubricant costs.

In comparing the maintenance expense for 1966, Transit estimated that it would be the same as the twelve-month period ended June 30, 1965 ($4,249,452), plus increases due to increased costs of operating additional air-conditioned buses, additional miles on Silver Rocket Service, additional miles in charter business, increases in payroll and fringe benefits, minus savings due to reduction in price of fuel and other minor adjustments.

In computing maintenance expense for 1966, the staff estimated that it would be the same as the twelve-month period ended June 30, 1965 ($4,249,452), plus increases due to additional miles on Silver Rocket Service, additional miles in charter business, increases in payroll and fringe benefits, minus savings due to reduction in prices of fuel and savings due to adding 200 new buses operating at maintenance costs of approximately 6¢ per mile which replaced old buses operating at maintenance costs of approximately 25¢ per mile.

It is the Commission's view that Transit did not make proper adjustments to the maintenance costs for the twelve-month period ended June 30, 1965, in estimating maintenance costs for 1966. The most important adjustment should have been the savings in cost of operating 200 new buses versus 200 old buses, scheduled for replacement. The Commission is of the opinion that costs will be reduced when 200 old buses operating at maintenance costs of approximately 25¢ per mile, are withdrawn, and new buses which will operate at maintenance costs of somewhere between 6¢ and 8¢ per mile, are added to the fleet.

The staff estimate appears low, due, at least, to bus-assignment difficulty; on the other hand, Transit's original and rebuttal data fails to recognize any savings on account of the new buses in the latter half of 1965 and 1966 — in fact, Transit persisted in adding $41,000 to cost of maintaining air-conditioning units. Transit also failed to consider savings which may result from projected consolidation of operating divisions in early 1966.

The Commission is not unaware of the fact that in the last rate case involving D. C. Transit, Transit, by dint of careful management economies, was able to reduce operating costs in 1963 substantially below those projected in Order No. 245. Accordingly, the Commission accepts as reasonable the estimated maintenance costs projected by the staff.

7. *Estimated Cost of Legal and Witness Fees for Current Rate Case.* On rebuttal, Transit added $81,000 as estimated costs of processing this rate case. The Commission will allow this as a necessary and proper operating cost of 1966.

8. *Research Project for Bus Shelters.* The Commission takes judicial notice of a new research project scheduled for 1966 and 1967, aimed at the design and construction of bus shelters. The estimated cost of Transit's share in this demonstration project to be conducted in cooperation with the Housing and Home Finance Agency is $50,000 over a two-year period. Accordingly, the Commission will allow an additional expense for 1966 in the amount of $25,000.

9. *Adjustment of Fare on Downtown Minibus.* The Commission cannot ignore the obvious inequity in and inadequacy of the 5¢ fare now in effect on the downtown Minibus line. This rate of fare was instituted only as part of a research program subsidized jointly by Transit, the District of Columbia Government, Downtown Progress, and the Housing and Home Finance Agency. Now that the subsidy arrangement and the experimental phase have been concluded, it is manifestly unfair to continue the experimental rate. None of the participants in the Minibus Project contemplated the continuation of the fare at 5¢; Transit, for reasons of its own, has chosen to wait until this proceeding to ask to raise this fare. The Commission will permit Transit to change the Minibus fare to the more reasonable level of 10¢.

In taking this action, the Commission will recognize an increase in projected revenues for 1966 in the amount of $57,100, being the latest estimate in the record by Transit for this unit of service.

DEFICIENCY IN DEPRECIATION RESERVE

The deficiency in the depreciation reserve account of Transit was recognized by Order No. 381, served September 11, 1964. This Order, which was based on a study by the Stone & Webster Service Corporation, as of August 15, 1963, established individual depreciation accounts for each class of assets as of January 1, 1964. It also established rates of depreciation to be applied to each class of assets. In establishing the new accounts reflecting depreciation reserves for each class of property, it was determined that the reserve for depreciation heretofore carried on the books was deficient in the amount of $1,223,099.04. The new reserves for depreciation were established on the books as of January 1, 1964, and the $1,223,099.04 deficiency was placed in a suspense account. Since the date of that Order the suspense account has been adjusted for salvage credits realized from the sale of obsolete equipment. The balance remaining for disposition in this case is $1,099,627.

In Order No. 245, served April 12, 1963, discussion was had by the Commission on the item of depreciation reserve against buses. In that Order the Commission said:

> The testimony further developed that by May, 1961, the District of Columbia Public Utilities Commission, with the completed reserve requirement study in hand, determined that this over-accrual on buses had been substantially offset by under-accruals on other classes of company property, and by the unrecovered costs on rail facilities as projected to August 15, 1963.
>
> If the Court's decision is implemented, it further appears that the refundable revenues allocable to excess depreciation on buses will have to be allocated to rebuilding a deficient depreciation reserve.
>
> Here again the record in the 1960 rate case did not include the final results of the reserve requirement study by Mr. Ingoldsby because it had not been completed. The completed study, as subsequently noted by the District of Columbia [Public] Utilities Commission, indicated that any excess depreciation accrual on buses had been substantially offset by under-accruals on other classes of property and rail facilities.

Based on these statements from its 1963 Order, the Commission is inclined to transfer any such deficiency, such as we are here concerned with, to the Court-Ordered Reserve. The logic of charging this deficiency off against the Court-Ordered Reserve lies in the fact that just as the credits in the Court-Ordered Reserve represent a build-up over a period of years prior to the current year, so does the depreciation reserve deficiency represent a build-up of deficiency in past years' depreciation charges, to be made up in the current or future periods. It is clear to the Commission that this deficiency in depreciation charges should equitably be made up by charges to the ratepayer, but as to the techniques of preferring to accomplish this by a charge against a Court-Ordered Reserve in lieu of charging a particular period's profit and loss account, is merely a matter of semantics. Thus, whether the deficiency in the depreciation reserve which concerns us now is written off directly on the operating statement of a particular period or periods, or whether it flows first through the Court-Ordered Reserve, the impact on the rate-paying public is still the same. It is to this impact which the Commission addresses its concern. And if the Commission can dispose of this deficiency in one yearly period without causing an increase in fares, it appears to the Commission that this is the propitious time in which to make such an adjustment.

The Commission, as will be noted, has determined that the deficiency in this depreciation reserve can be charged to the year 1966 without causing a fare increase, and thus the Commission will close out this account against the operating revenues of 1966.

Now the Commission addresses itself to the question as to whether or not the ratepayers should be responsible for the entire $1,099,627 available for this disposition. The Commission, after considering all the testimony on the subject in this case, agrees with the logic and the conclusion that $293,459 of this deficiency should be shared by the buildings and properties which contributed to this deficiency, and which have, since August 15, 1963, been placed below the line. Therefore, the remaining amount of $806,168 will be utilized at this time as a charge above the line. Transit is directed to close out the balance in this deficiency account by crediting the account in the amount of $1,099,627 and contra-debiting the depreciation expense account (above the line) for 1966 in the amount of $806,168, and depreciation expense (below the line) in the amount of $293,459.

INCOME TAXES (INVESTMENT TAX CREDIT)

Neither Transit nor staff exhibits flowed through any benefits that might accrue to Transit under the investment tax credit provisions of the Internal Revenue Code. This is in accordance with Commission action in rate cases which were processed through this Commission since the 1964 Revenue Act was passed. In each of three major rate cases decided by this Commission since February 1964, when the 1964 Revenue Act became law, the Commission's policy has been to comply with the intent of Congress as expressed in Section 203(e) of the 1964 Revenue Act. The pertinent provision of that section follows:

> It was the intent of Congress in providing an investment credit under Section 38 of the Internal Revenue Code of 1964, and it is the intent of the Congress in repealing the reduction in basis required by Section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to taxpayer shall, without the consent of the taxpayer, use --
>
> (1) in the case of public utility property . . .
>
> (2) . . . any credit against tax allowed by Section 38 of such code, to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method.

The Commission finds no reason at this juncture to change its policy with respect to treatment of the investment tax credit. However, any benefits flowing to Transit from these investment tax credits will not be ignored by the Commission in any cash flow considerations.

PROJECTED OPERATING STATEMENT FOR 1966

The findings of the Commission in relation to the operating forecast projected for 1966, incorporating all of the foregoing adjustments, are summarized in the following statement:

Gross Operating Revenues, with no change in fares	$33,281,682
Additional revenues to be generated by increase in downtown Minibus fares	57,100
Total Gross Operating Revenues	$33,338,782
Operating Revenue Deductions, as adjusted	$32,641,725
Net Operating Revenue, before income taxes	$ 697,057
D. C. Income Tax chargeable for Track Removal Costs, in conformity with "net of taxes" procedures	48,700
Net Operating Revenue, after income taxes	$ 648,357

MARGIN OF RETURN

The Compact requires the Commission to "prescribe just and reasonable" fares. A just and reasonable rate is one that assures that all the enterprise's legitimate expenses will be met and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to provide both the form and substance of financial strength and stability. Sections 6(a)(3) and (4) of the Compact indicate that the Congress and State legislatures intended that the operating ratio method should be the primary test of the reasonableness of Transit's fares. We turn now to a determination of what is a proper margin of return, that is, the difference between operating revenues and expenses, for this particular proceeding.

Two expert witnesses testified at length in connection with a proper margin of return for Transit, one of the witnesses testifying for Transit and the other for protestant-intervenor. The staff's Chief Accountant [2] testified as to the problems involved in rate-making, and as to why the operating ratio method is a better tool than the return-on-investment procedure in arriving at rates of return for the transit industry.

Transit's expert witness testified as to his opinion, based on a study he had made, of what would constitute a fair and reasonable rate of return for Transit. His study included a review of: (1) rates of return, on both the operating ratio and rate base methods, allowed by regulatory authorities and courts in cases involving not only transit companies, but telephone companies, electric companies, and gas companies; (2) yields on government obligations and on public utility bonds for the purpose of comparison with the cost of debt capital to Transit; (3) financial data concerning the capital structures and rates of return of Transit and other privately owned transit companies, natural gas transmission companies, natural gas distribution companies, and Class A and B electric utilities; (4) comparisons of the market price trend of the common stock of D. C. Transit System, Inc., of Delaware, with market price trends of the common stock of other regulated utilities; (5) dividend pay-out ratios of Transit in comparison with privately owned transit companies and other regulated public utilities; (6) comparisons of the growth in gross plant of Transit with the growth in gross plant of other privately owned transit companies; (7) price-earnings ratios of other privately owned transit companies and other reg-

[2] The role of the Commission's staff in rate cases, as set forth in Order No. 245, served April 12, 1963, is to objectively scrutinize and analyze all data having a bearing on the case; this precludes the staff from assuming a partisan or adversary posture. The staff therefore makes no recommendations as to fair return.

ulated utilities for the purpose of comparison with the price-earnings ratios of Transit; (8) data showing a comparison of revenue passenger history of Transit with that of other privately owned transit companies; and finally, (9) the history and projection of Transit's income, rate base, equity and dividends from 1956 through 1966.

Mr. V. A. McElfresh, Transit's expert witness, testified that the interest rates of Transit averaged 5.75% on an annual basis as of June 30, 1965. He further testified that interest rates on government obligations are generally considered to be representative of pure interest cost with a minimum of risk. His study revealed an upward trend in the yields on public utility bonds from 1960 through June, 1965. He concluded that the effect of this upward trend of interest rates would be to increase the cost of borrowing money for all utilities, and Transit must generate increased earnings to pay these increased interest rates if its financial structure is not to deteriorate. He also compared the average interest cost of other transit companies with the interest cost of Transit, and concluded that the current 6% being paid by Transit on equipment purchases is a higher interest rate than is being paid by any other transit company for which data was available. Cross examination of his testimony brought out, however, that his study included a period of time too far in the past and did not include sufficient detail for us to give this factor significant weight. While he has not convinced the Commission that Transit is currently paying a higher interest rate than the average transit company for equipment purchases, Mr. McElfresh attempted to justify a higher interest rate because of the high debt ratio of Transit. He then went on to state that a higher debt ratio results in a higher interest cost because a debt investor runs a greater risk in a company having a high debt ratio in comparison with a company having a much lower debt ratio. The witness introduced and discussed a compilation of comparative data of the capital structure of regulated utilities other than transit companies. This was used in his testimony as a basis for comparison of the capital structure of Transit with other privately owned transit companies. He stated that return on total capital and return on equity capital comparisons clearly indicate that investment in the transit industry is considerably less attractive than investment in any of the other groups of utilities displayed in his exhibits. The witness reviewed operating ratios allowed by regulatory commissions and courts in transit rate cases during the years 1955 to date. Of the 24 opinions and orders reviewed, 15 were utilized by the witness. The operating ratios ranged from a low of 91.6% to a high of 96.5%. In his opinion, this range of operating ratios establishes a yardstick to aid in establishing the fairness of the operating ratio to be determined for Transit in this proceeding. His testimony also included the discussion of the use of the operating ratio method as a basis for the regulation of utility rates and contained the observation that this method is used almost exclusively in the fixing of rates for the transportation industry. The major reason for this, he stated, is the wide difference in the relationship of gross operating revenues to capital investment. Each dollar of capital investment in a transit company will produce well beyond a dollar in gross revenue. The comparable ratio in the other regulated utilities is different, in that generally, an investment of three to five dollars is required to produce one dollar of gross revenue. He noted that another substantial factor was the fact that labor cost constitutes a greater percentage of the operating expenses in the transit industry than in other regulated utilities. He gave the opinion that this points to the great significance of a small percentage increase in cost on the profits and financial well being of transit companies.

The witness also made a study and analysis of rates of return on system rate base allowed by regulatory authorities and courts; it included regulated utilities and other industries as well as the transit industry. He noted that transit companies have been allowed a higher return on rate base than have other regulated utilities and drew the conclusion that this was the result of the much greater risks in the transit industry than in other regulated industries.

This witness also presented evidence relating to price-earnings ratios of selected companies, concluding that the investor confidence in Transit is substantially less than in other regulated utilities. He concluded that this demonstrates the need for increased earnings.

He gave evidence that Transit is experiencing a growth in plant which is contrary to the practice in the industry and thus highlights the risk to the equity owners, such expansion justifying a higher rate of return.

The witness testified that it was his opinion that the average return on the rate base of 5.25% in the future annual period is definitely on the low side. He also concluded that a return of 20.97% on common stock equity is likewise low, taking into consideration the high debt ratio of Transit and the risk associated in the transit industry generally and Transit in particular. The witness also mentioned the added risk faced by Transit as a result of the new subway to be built within the next 5 to 7 years, which is well within the life of Transit's franchise, and which would operate, according to the witness, in direct competition with Transit along all of its arterial routes.

It was the opinion of this witness that a return of 25 to 30 percent on the equity capital of Transit would be entirely reasonable. In arriving at this opinion, he noted that the risk of investment in Transit is more than double the risk of investment in other regulated industries, and therefore the rate of return for Transit should reflect a greater return for this risk. Such a return, he concluded, was necessary to enable Transit to maintain its annual dividend pay-out of $500,000 a year. He stated that the market place assumes now the continuation of this same amount which has occurred every year since

1960. It was his opinion that if the annual pay-out was not continued, the adverse effect on the market value of the stock of the parent would be considerable, and the financial stability of Transit would deteriorate in the eyes of the financial community. All of these factors led the witness to believe an overall return of not less than 10% on the rate base of Transit is necessary to accomplish and arrive at a reasonable rate of return. Finally, he concluded a return on gross operating revenues of 8% would be a fair and reasonable return, and that Transit's projected margin, with new fares as applied for, was well within this range.

The intervenor-protestant expert witness, Mr. Bernstein, testified as to what in his opinion would be a fair rate of return. This witness determined a fair rate of return on the basis of cost of capital, which cost was derived by combining the applicant's past cost of debt capital and past cost of equity. The latter was arrived at from a study of earnings-price ratios and dividend-price ratios of selected transit and other regulated utility companies. It was his opinion that the risks attendant on Transit were embraced within his cost of capital study and analysis. Based on his study, this expert witness concluded that a fair cost of equity capital for Transit falls in the range of 12 and 13 percent; he recommended that the Commission allow Transit a return on equity capital of that amount in setting fares in the future period. Mr. Bernstein based his calculations on an equity investment of approximately 4-1/2 million dollars, resulting in a return of $550,000-$600,000. He also recommended that the Company be permitted to earn the aggregate dollar amount required to service its debt in 1966, which was estimated to be $957,000. Thus, his recommendation was that a fair return to Transit should be between $1,500,000 and $1,550,000.

The intervenor's expert witness recommended a gross operating revenue margin of return of 4.5% to 4.75%, which equates to an operating ratio of 95.25% - 95.5%

and, on a base of $33,000,000, a return of about one and a half million dollars.

The staff's Chief Accountant, Melvin E. Lewis, explained the basic difference between fixing rates for fixed plant companies and transit companies in the following language:

> . . . The return on rate base of the fixed-plant companies should ordinarily be lower percentagewise than the return on the lower fixed-plant of motor carriers. The rates of return on gross operating revenue show up in a striking fashion when we compare the margin of return on gross operating revenue of the fixed-plant companies with that of the motor carrier; the return on gross operating revenues of the fixed-plant companies is substantially higher than the rate of return on gross revenue of the motor carrier. This is the normal situation, because as the District of Columbia Court of Appeals indicated this past summer in the D. C. Transit rate case, the risk in the motor carrier industry inheres in the operating costs whereas the risk in the fixed-plant companies inheres in the plant investment. Therefore, we are constrained to exercise more attention to the return on rate base for fixed-plant companies and on return on gross operating revenues for the motor carriers.

Mr. Lewis went on to explain why the operating ratio theory of rate making has replaced the return on investment theory almost universally as a tool for rate making in the motor carrier industry in the following language:

> It is generally recognized that the theory was proposed as a means of overcoming the deficiencies which have been attributed to the general use of the ratebase theory as applied to the motor carrier industry. The term 'operating ratio' may be broadly defined as the relationship between expense and gross revenues, or, as referred to in the Compact, a return on gross operating revenues.
>
> The reason for adoption of the operating ratio theory for the motor carrier industry was the fact that

the investment or ratebase theory ceased to meet the acid test of reasonable earnings.

The average motor carrier has a relatively small investment compared to total operating expenses. The investment of the motor carrier is largely confined to relatively short-lived rolling stock. In view of the practice of equipment leasing prevailing in the industry, it is not uncommon for a motor carrier to provide adequate service with little or no investment. Consequently, there is frequently little correlation between booked investment and the standard of service rendered to the public.

Any attempt to relate a consistent and uniform rate of return to investment or rate base in the motor carrier industry is met, more frequently than not, with many frustrations. While a given rate of return on investment might produce an adequate return for one carrier, the same return could very well be inadequate to pay the cost of debt of another carrier. Furthermore, since the rate base of a given carrier is subject to rapid and major fluctuations, the rate of return will also fluctuate widely even though the net earnings remain constant.

The industry feels immediately the impact of economic aberrations such as strikes, increased labor costs, decline in patronage, and even changes in the weather.

The net earnings of a motor carrier are drastically influenced by every minor percentage change in either projected revenues or expenses. A percentage return based solely on the much smaller rate base investment is generally inadequate to compensate the investor for the risks inherent in such fluctuations.

The motor carrier industry, in general, and the passenger transit industry in particular, is sensitive to serious competitive forces, primarily due to the convenience and comfort of the private automobile. Contrarywise, the fixed-investment type utility enjoys a substantial monopoly in its sphere of operations.

The above factors, peculiar to the motor carrier industry, and the need to devise an appropriate

> means to compensate the carrier for its inherent risks, lead to the abandonment of the rate base theory in favor of the operating ratio theory.
>
> The percentage spread (between revenues and expenses), is generally fixed to allow the carrier a sufficient number of dollars to cover, among other things, (1) interest charges; (2) withdrawals or dividends large enough to pay a return on investment; (3) a contribution to surplus which may be used for modernization; (4) a cushion for cyclical swings in business; and (5) the time lag between wage and other expense increases and the effective date of fare relief.
>
> Since it is not feasible to assign a dollar value to each of the varied and sundry risks inherent in the motor carrier industry, the accepted approach is for the regulatory commission to establish a reasonable percentage spread which will compensate the carrier for its investment, its cost of money and the numerous other risks inherent in the business. The Compact suggests that a ratio spread of at least 6-1/2% . . . shall not be considered unreasonable.

None of the expert witnesses disputed the requirement under the Compact that the Commission must utilize the "operating ratio" as the primary method of rate-making; they differed only as to the margin of return — the difference between revenues and expenses.

Section 6(a)(3) requires the Commission:

> . . . [to] give due consideration, among other factors, to the inherent advantages of transportation by such carriers; to the effect of rates upon the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable such carriers, under honest, economical, and efficient management, to provide such service.

Section 6(a)(4) also instructs the Commission:

> [A]s a matter of legislative policy . . . in order to assure the Washington Metropolitan District of an

> adequate transportation system operating as private enterprises, the carriers therein . . . should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors. As an incident thereto, the opportunity to earn a return of at least 6-1/2 per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

The Court of Appeals for the District of Columbia Circuit in a prior case[3] involving Transit laid down guidelines in the following language:

> A "just and reasonable" rate is one that assures that all the enterprise's legitimate expenses will be met, and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide both the form and substance of financial strength and stability."

The rate-of-return testimony of these three expert witnesses must be related in some measure to gross operating revenues, Transit's rate base and stockholders' equity.

We have already determined that projected gross operating revenues for Transit for the year ending December 31, 1966, will be $33,338,782.

Transit projected a rate base at December 31, 1966, in the amount of $28,208,541. The staff projected Transit's rate base as of the same date to be in the amount of $27,105,665, and also projected an average rate base for the future annual period in the amount of $26,219,357. The intervenors and protestants did not present any rate base evidence. One of several reasons for the difference between Transit and staff estimates of rate base is the treatment accorded the balance of the acquisition adjust-

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[3] D.C. Transit System, Inc. v. Wash. Metro. Area Transit Commission, 350 F.2d 753, 778 (1965).

ment account. Although the acquisition adjustment account once had a major impact in rate base calculations, the balance in the account is now small enough to be of little consequence. For purpose of this case, and as a check for determining the reasonableness of earnings allowed Transit in the year 1966, we find that a rate base of $27,000,000 is accurate enough; technically, an averaged rate base for a future period is much more valuable than a year-end figure, but there were many adjustments in Transit's projected rate base which were not clearly developed in Transit's testimony nor included in the staff's projection. The only saving factor is that the entire range of difference, from a $28,000,000 high to a $26,000,000 low, related to an earnings figure of $2,000,000 will cause a disparity of only a trifle more than 1/2 of 1% in the rate of return on rate base.

There was considerable testimony on the subject of stockholders' equity in Transit. During the hearing, the Commission asked for, and received from its Chief Accountant, a breakdown of assets and liabilities per Transit's books as of that date, showing which were involved in Transit activities and which were not. There is no question but that total Transit assets of $27,082,392.14 minus total transit liabilities and reserves of $25,827,-407.09 produces an equity figure, attributable to transit operations, of $1,254,985.05. However, the Commission will utilize in succeeding calculations the overall equity balance of $4,562,825.07, considering that the net assets thus represented of a non-transit nature are available at all times for, and in furtherance of, the fiscal needs of Transit.

Transit's debt-equity ratio is approximately 80-20. It is quite obvious that this relationship is far above the norm. On the other hand, analysis of the components of the rate base of Transit reveals a very modern fleet and plant. In fact, the high quality of the assets in the rate base of Transit allays any fears that the small amount of stockholders' equity may interfere with Transit's responsibility for rendering good service to the public.

Transit has acquired 739 new, air-conditioned buses since 1958 at a capital cost of $24,000,000, and is presently under orders from the Commission to purchase an additional hundred such buses each year. The real criterion as to the quality of Transit's equipment, and consequently its service, is not revealed in terms of stockholders' equity but largely in terms of Transit's rate base. Although it may be immaterial to the bus rider, in terms of service, whether debt capital or equity capital is used to purchase the bus he rides in, the important point is that this Commission must assure the bus rider that the fare he pays is not burdened with an unreasonable cost of capital. There was much discussion in the record concerning the debt-equity ratio. In fact, this Commission has in the past been critical of Transit's method of financing, and has expressed concern over the increasing ratio of debt to equity. This solicitude does not represent a fear on the part of the Commission that a return based on the operating ratio theory of rate making will result in an excessive return to Transit on its book equity; indeed, this record is clear, and every witness testifying on the subject agreed that debt capital is cheaper than equity capital. The main concern of the Commission in relation to this entire problem is that the high debt ratio might, at some time, adversely affect the financial stability of Transit, which could result in higher costs for debt capital or the inability of Transit to borrow money altogether. At the present time Transit is paying 6% interest on its debt to acquire new buses. The expert witness for protestant-intervenor testified that a return of between 12% and 13% on equity represents a reasonable return for Transit. Transit's expert witness indicated that a much higher return was just and reasonable. In order to fully appreciate the testimony to the effect that debt capital is cheaper than equity capital one has only to relate the lowest percentage of return on equity recommended in this case (12%) to Transit's outstanding debt of $15,877,096. If this debt capital were in fact equity capital, Transit would then be entitled to a return on total equity in the amount of $2,452,790. Cost of debt capital would amount only to one-half of this sum. Added to this would be the traumatic effect on the income tax liability, which, having no interest expense deduction available, would increase by some $450,000 per year, equivalent to a reduction in the return on gross operating revenue of 1-1/3%. Our main concern thus is that Transit continue to provide adequate and convenient transportation service with modern equipment and at reasonable fares. The uncontradicted testimony establishes that Transit is performing service at the lowest basic fares of any comparable private bus operation in the United States. That it is giving reasonable service is reflected in its revenue passenger statistics. Indeed, the projected increase in riding for 1966 over 1965 is one of the reasons why the Commission will be able to hold the fares at their present level. This upward trend of riding is occurring at a time when the industry generally is continuing to suffer a declining trend in riding. In the final analysis, then, we are primarily concerned as to whether or not Transit is meeting its obligations to the public at the minimum costs. If it can meet this obligation to the public with debt capital cheaper than equity capital, then it is not appropriate to criticize a high percentage return on a low equity, if in the final analysis the cost to the ratepayer is less.

We do not want to be misunderstood. Transit's debt-equity ratio should not be allowed to deteriorate further. The entire matter, however, of return on equity must be kept in proper context.

Every witness testifying on the subject agreed that in determining Transit's margin of return the Commission must include an allowance to cover Transit's interest on debt. Transit's cost of debt in 1966 will be approximately $960,000.

Transit has paid an annual dividend of $500,000 since 1960 and the testimony tends to show that the market place assumes the continuation of such dividend. The expert witness for the protestant-intervenor did not agree with Transit as to the requirement for overall earnings, but he saw an advantage to continuing annual dividend payments at the $400,000 level, being the amount flowing through to the holders of the Delaware Company's stock.

We are of the opinion that the intervenor's cost-of-capital method of determining a fair rate of return for Transit in this proceeding is not wholly applicable to the transit industry generally and to Transit in particular. Mr. Bernstein stated that any conclusions under his approach must still be subject to the application of good judgment; and many factors which might influence one's judgment were not fully developed at the time of his testimony.

Having determined that the margin of return must include $960,000 as cost of debt and $400,000 to $500,000 for annual dividend, we must now determine how much additional money is required to enable Transit to maintain a sufficient surplus to cover contingencies and to assure the financial stability of Transit. The following contingencies must be considered by the Commission in arriving at a judgmental figure for Transit for 1966:

Admittedly, the Commission has been conservative in its estimates for future revenues and expenses. In fact, the difference between the net operating income projections of the Commission and Transit amounts to more than $800,000. The Commission feels that in prescribing rates under the operating ratio method it should be careful not to over-estimate revenues or expenses since the rate of return is directly geared to these items. If we, even inadvertently, should include margins of error, in the estimated operating revenues or expenses, we would be allowing a return on such errors. The great possibility of error in estimates and projections, a very real contingency, thus is better given weight here in the margin of return allowed than above the line where the effect would be compounded.

Unless Congress acts to remove Transit's obligation to remove and/or repave old streetcar track, the possibility exists that Transit might incur considerable expense over and above the amount which remains in the track removal reserve in 1966. There is also the risk that the track removal program could be accelerated during the future period.

It is most difficult to evaluate the effect that the recently enacted subway legislation will have on the confidence of the investor in Transit, hence the effect on market price of its stock and Transit's ability to attract new capital.

With reference to revenue projections, a mere 1% drop in passenger revenues under that projected by the Commission could result in a reduction of approximately $300,000 in collections in 1966.

We cannot ignore the fact that the present labor contract expires on November 1, 1966, and that there is a possibility that the Company will incur additional labor costs for the last two months of the year.

One factor which might ordinarily ameliorate some of the risks discussed above is the schoolfare subsidy. Public Law 87-507 requires that calculation of the return for determining eligibility be limited strictly to "mass transportation operations in the District of Columbia." All certifications by this Commission under Public Law 87-507, thus far, have developed rates of return for D. C. mass transit operations only which were much greater than the actual system-wide rates of return. It is the view of the Commission that Transit is not likely to qualify in 1966 for any subsidy under the schoolfare subsidy law, irrespective of the level of overall earnings.

Upon consideration of the above factors, and the numerous other normally anticipated problems, including the forecasting of charter revenue, management economies, or difficulties to be encountered on account of organization changes, plant relocation and the myriad other day-to-day problems, which multiply the difficulties of prognostication, it appears to the Commission that a margin of some $550,000 to $650,000 is a fair and reasonable allowance to provide Transit as a cushion over and above interest and dividends to assure some measure of financial stability for Transit in 1966, under extant circumstances.

The Commission therefore finds that a margin of return above operating expenses in the amount of about $2,000,000 is fair and reasonable for 1966, and will enable Transit to service debt, pay reasonable dividends, and retain a sufficient surplus to cover various contingencies. This margin of return will produce a rate of return of 7.4% on Transit's rate base, discussed heretofore. Considering the numerous risks attendant upon Transit's operations, when such a return is related to other regulated utilities without similar risks, we feel that 7.4% return on Transit's rate base is low. In view of the standard of service provided by Transit, we consider that the margin of return authorized herein provides a fair return.

COURT-ORDERED RESERVE

As a result of appeals from the rate case decisions of the District of Columbia Public Utilities Commission of March 2, 1960 (Order 4631), and January 18, 1961 (Order 4735), the United States District Court for the District of Columbia established a *Special Court-Ordered Reserve*. The Reserve was established in September, 1963, with a credit of $2,350,000, offset on the books by a charge to depreciation reserve in the amount of $500,000, a charge to depreciation reserve in the amount of $1,000,000 and a charge against the reserve for track removal and repaving in the amount of $850,000. Since that time, expenses authorized by the Court, and paid out of the Court-Ordered

Reserve, have reduced the balance now available in this Reserve to $2,166,933.21. The Court Order which established this Reserve stated that this account "... will be available for utilization, within its discretion, by the Commission having regulatory authority ... provided such discretion is exercised consistently with the purpose of benefiting transit users in any rate proceedings pending or hereafter instituted concerning D. C. Transit System, Inc."

We interpret the mandate of the Court to mean that before Transit can be authorized to collect additional revenues through higher fares, the Court-Ordered Reserve must first be depleted. We know of no more direct way of benefiting the transit rider than by using the funds in this Reserve to help avoid an increase in fares.

As will be noted elsewhere in this Order, Transit is expected to realize net earnings, under present fares, in 1966, in the amount of $648,357.[4] As noted above, the funds available in the Court-Ordered Reserve amount to $2,166,933.21. Restoration of the depreciation reserve deficiency in the amount of $806,168 can be accomplished by removing this amount from the Court-Ordered Reserve, leaving a balance in the Court-Ordered Reserve of $1,360,765.21.

The Commission, in the discussion of the margin of return to which Transit is entitled, has concluded that Transit is entitled to net earnings in the amount of approximately $2,000,000 in 1966. Since Transit is expected to experience net earnings of $648,357 under present fares in 1966, it must be allowed additional return in the approximate amount of $1,350,000. Credits approximating this amount, remaining in the Court-Ordered Reserve, are now available to Transit. If the entire amount available in the Court-Ordered Reserve is used for this pur-

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[4] This assumes a Minibus fare of 10¢.

pose, Transit's net earnings in 1966 are projected to be $2,009,122 or a return on gross operating revenues of 6.03%.

Accordingly, the Commission is now utilizing this Court-Ordered Reserve for the purpose for which it was intended by the Court. The Commission recognizes that the transfer of the credit in this Reserve to the net operating profit line of Transit for 1966 does not of itself generate operating cash for the use of Transit; it also is cognizant of its responsibilities under regulatory law to utilize the credits in this Reserve in lieu of operating income for the purpose of directly benefiting the ratepayer. This Reserve represents a reservation of excess revenue funds collected in some past years, and the ratepayer cannot be called upon to furnish these funds a second time, nor should Transit expect a second supply of cash funds for this item.

Much testimony and cross-examination revolved around the taxability of the Court-Ordered Reserve if treated, or not treated, in a particular fashion on the books of Transit. The Commission is aware of the fact that Transit's expert on this matter testified only that if a portion of the Court-Ordered Reserve were ordered to be credited through the income statement as a type of income or used as a means to increase income (referring to the $850,000 originating from the track removal reserve), this mere procedure of flowing the adjustment through income rather than back through the reserve for track removal "might well cause the Internal Revenue Service to attempt to tax such amount as income."[5] The expert witness at no point was willing to discuss the taxability or non-taxability of the item under any accounting procedure, but limited his testimony absolutely to discussing only the fact that in his opinion the transfer of $850,000 of the Court-Ordered Reserve credit to operating income would "give rise to a

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[5] Exhibit 70, p. 4.

question of their taxability." [6] None of the cases cited by this expert, and included in the record, appeared specifically relevant to the problem involved here.

The fact remains, however, that there has been no positive testimony as to the taxability of all or part of the Court-Ordered Reserve credit, although there has been negative testimony on this subject. The further fact remains that Transit has been and remains on a flow-through basis for income tax purposes as far as this Commission is concerned in the establishment of rates of fare. Thus, no injury can accrue to Transit from any future tax decisions affecting Transit due to action by this Commission. All tax liabilities developed over the years, from year to year, by action of the Internal Revenue Service, are passed through the accounts and paid for by the ratepayer. The Commission is not unmindful of the fact that just in the past year the tax liabilities of Transit's predecessor were settled, involving tax and interest costs to Transit as well as to its predecessor; these tax adjustments were taken up on the books and will, in due course, be borne by the ratepayer through the acquisition adjustment account. The Commission also knows that Transit's tax returns for the period beginning August 16, 1956, through the year 1964, have not been finally accepted by the Internal Revenue Service; there remain several major items involving serious tax consequences that have not yet been finalized. [7]

[6] Exhibit 70, p. 5.

[7] Federal income taxes, skimming off 48% of net profit, have a major impact on utility rates — requiring revenues of twice the magnitude which would be required to arrive at a fair return if income taxes were not involved. The operation of the income tax on privately-owned utility companies is thus regressive, resulting in the ratepayer indirectly, but definitely, paying the income tax. It is clear to this Commission that the patrons of privately-owned utilities are at a great disadvantage compared to the patrons of publicly-owned utilities when the former are liable for corporate income taxes whereas the latter are exempt.

[Continued, next page]

The Commission finds it proper at this time to transfer the entire credit balance in the Court-Ordered Reserve to 1966 retained earnings.

In allowing Transit to transfer the funds in the Court-Ordered Reserve to its Retained Earnings Account, the Commission must emphasize that should there develop a substantial disparity between net operating income in 1966 and the amount projected in this Order, so that the net operating income experienced in 1966 is substantially greater than the amount provided for in this Order, the Commission reserves the right to reduce the amount transferred. For instance, if Transit fails to place in service on or before June 1, 1966, 100 new air-conditioned buses, an appropriate amount would be restored to the Court-Ordered Reserve Account. It is just noted, in passing, that the depreciation expense projected for 1966 includes $153,650 applicable to such new buses and consideration also has been given to interest payments in the amount of $113,094, covering the purchase of these new buses, and principal payments in the amount of over $160,000 for the financing of these buses.[8]

This Commission feels very strongly that the elimination of the income tax on mass transit carriers would be a major step toward accomplishing a comparability of fare structures between privately-owned and publicly-owned carriers; it would correct a major inequity in that the transit rider in the Metropolitan District is being penalized by having to cover the income tax assessed the privately-owned carriers.

We would like to see this Congress enact legislation to correct this inequity on the ratepayer; this would be in line with other forward-looking tax measures already enacted and being considered by Congress.

[8] Transit's entire depreciation schedule for its current fleet of buses hinges on the purchase each year of 100 new buses.

CASH FLOW

The Commission is sympathetic with the cash management problems which will face Transit due to the need to flow into income, credits from reserves set up in the past and containing no cash for present use. Immediately following is a statement showing sources and application of funds for Transit if 1966 projections prevail. This statement indicates that there will be sufficient cash coming through the fare box, even if the acquisition adjustment entry is excluded, to cover all of the forecasted principal and interest payments required in 1966, assuming the purchase of 100 new buses as of June 1, 1966. In preparing this statement, two items were omitted and should be commented upon in passing.

One of the items omitted is provision for possible investment tax credit rebate, as well as any other tax refunds, whether they be carried back to past years or carried forward to future periods. Even though investment tax credit is not being considered in the determination of rates in accordance with the intent of Congress as expressed in the 1964 Tax Code, the presence of cash refunds generated by the investment tax credit or tax loss carrybacks is certainly a major factor in studying Transit's cash flow problem. This is definitely a source of funds for Transit. The Commission is advised of the possibility of tax refunds for 1966 from carrybacks to 1963 of $296,000 and to 1964 of $196,000; this depends, of course, on the effect of 1965's tax return, when filed, which may generate more tax refund possibilities. Investment tax credits available in 1965 were over $750,000 but the technicalities involved in the utilization of this credit in 1965 and in 1966 make it impossible to arrive at any definite or accurate forecasts.

The second item omitted, of course, is the cash dividend which Transit has been paying during past years. This would indicate a need for Transit to switch to a stock dividend, which would have the dual advantageous effects of alleviating the cash problem for 1966 and of increasing the equity investment in Transit by the investors.

SOURCES AND APPLICATION OF FUNDS-D.C. TRANSIT SYSTEM, INC., PROJECTED FOR 1966

Projected Net Operating Revenue excluding non-cash income tax provisions	$ 697,057
Add: Non-Cash Charges for depreciation expense	2,812,704
Net Funds Generated	$3,509,761
Servicing of Loans:	
Principal	$(2,344,000)
Interest	(956,945)
Excess of Funds	$ 208,816
Exclusion of Acquisition Adjustment Entry from Income	$ (194,516)
Pure Cash Flow Excess	$ 14,300

The following statement incorporates the final determinations of this Commission for Transit for 1966:

OPERATING STATEMENT FOR D.C. TRANSIT SYSTEM, INC. (D.C.) PROJECTED FOR 1966

Gross Operating Revenues	$33,338,782
Net Operating Revenue, after income taxes	$ 648,357
Special Adjustments for 1966: Deficiency in Reserve for Depreciation, closed out	(806,168)
Balance in Court-Ordered Reserve, closed out	2,166,933

Net Transfer to Retained Earnings for 1966	$ 2,009,122
Return on Gross Operating Revenues ($2,009,122 ÷ $33,338,782)	6.03%

In arriving at its decision, the Commission has carefully weighed and evaluated all testimony and exhibits. It is neither possible nor feasible to set forth every detail of evidence adduced or argument made in this proceeding. Nor is it possible to detail in every respect our judgmental evaluation of those factors. We have evaluated the evidence and arguments within the previously enumerated statutory guidelines. Nevertheless, the vision of the Commission must not be limited to the horizon of a particular proceeding. The effects of our decision herein must also be considered in the context of tomorrow as well as today. The end result of our decision must be the movement of the greatest number of passengers at the lowest possible fare. Without the roadblock that a fare increase always creates through passenger resistance, the trend of increased passenger usage of mass transit will continue. Hopefully, through increased cooperation among all segments of our Metropolitan District, including the operator and the public and its governmental bodies, counterbalances can be attained to offset the spiralling fiscal demands that the future portends. Increased usage of public transportation facilities benefits everyone. We take this opportunity, then, to issue a call for assistance and cooperation. We are confident that the operator, the public, civic and governmental units will respond. If the community at large will unite in a great endeavor to stimulate the use of mass transit, we will reach the multiple goals we all want — reasonable fares, good service, and manageable traffic conditions on our streets.

The Commission finds that the existing fares, except for the Downtowner Minibus service, as augmented by the Court-Ordered Reserve, are just and reasonable in that they will meet the revenue requirements of Transit.

The Commission further finds that the rates and charges proposed are unjust and unreasonable in that they would produce revenues in excess of the financial requirements of Transit; except that the proposed fare for the Downtowner Minibus service is just and reasonable, and should be granted.

THEREFORE, IT IS ORDERED:

1. That the application of D. C. Transit System, Inc., for increases in fares as set forth in Supplement No. 1 to WMATC Tariff No. 29 and Supplement No. 2 to WMATC Tariff No. 28, be, and it is hereby, denied, except as hereinafter provided, and said supplements be, and they are hereby, rejected.

2. That the application of D. C. Transit System, Inc., for an increase in fare for the D.C. Downtowner Minibus service from five cents (5¢) to ten cents (10¢) be, and it is hereby, granted, effective February 6, 1966. An appropriate supplement shall be filed on or before that date.

3. That the accounting treatments set forth hereinabove shall be complied with as described.

BY DIRECTION OF THE COMMISSION:

DELMER ISON
Executive Director